REMARKS OF MICHAEL E. FRYZEL

BOARD MEMBER, NATIONAL CREDIT UNION ADMINISTRATION

NEW JERSEY CREDIT UNION LEAGUE

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Thank you, Paul. It is a pleasure to be here for the 76th annual meeting of the New Jersey Credit Union League and again be with the good people of the Garden State.

New Jersey credit unions have repeatedly been in the forefront. You have a reputation nationally for being on the front lines of some of the most important issues facing credit unions. A notable one that comes to mind is the Credit union National Mortgage situation. True, credit unions in other states were affected, But no group of credit union leaders did as much to shed light on the issue, or effectively press your case, as did you here in New Jersey. And clearly you've made progress, and gotten results.

I think that's a by-product of your very direct, very personal approach to governmental affairs. Your league president and your leadership, are particularly effective at making politics relevant in the lives of your credit unions. And that's a good recipe for continuing success in this business.

I am pleased to see that your conference proudly displays your League's new branding and logo, with the theme of "Banking You Can Trust." Your refreshed branding is perfectly timed, appealing to consumers WHOSE trust in banks has been shaken during the recent financial crisis. Reminding them that "banking" does not have to happen at an institution called a bank – but can also take place at a credit union, – is a fine way to spread the news about the value of credit unions: that high-quality, low-cost financial services are readily available – in federally insured institutions – beyond just the banking system.

No financial institution embodies the civic-minded values of "people helping people" better than America's credit unions. That is why, surveys continue to show that the level of consumer trust in credit unions is higher than in any other type of financial institution.

Faith in credit unions remains strong, but public confidence must be earned every business day. The past several years of economic erosion have taken a toll on all types of financial institutions – and credit unions are no exception.

The good news for New Jersey credit unions, is that your share growth, asset growth and loan growth all improved significantly over the past year – at a pace far better than the national average.

The overall strength of New Jersey credit unions is also above the national average. Nationally, 80 percent of credit union assets are in institutions in the strong categories of CAMEL 1 and 2; in New Jersey, it's 84 percent.

But despite that good news, here, like throughout the country, there is cause for concern. The latest numbers on New Jersey credit unions remind us that overall economic trends remain worrisome. Last winter, your net worth was slightly above the national average; as of midsummer, it has slipped below the national average. While credit unions nationally enjoyed 4 percent growth in net worth over the past six months, New Jersey's number was about negative 1 percent.

So, clearly, some tough-minded business decisions have to be made. Like the nation's credit union industry, New Jersey's credit unions now confront an array of challenges that will surely test your resilience. As the federal agency that ensures the safety and soundness of the credit union system, NCUA is committed to helping you navigate through these volatile times.

Keeping our credit union system safe and sound is NCUA's mandate, and that task is always foremost in our minds. In the aftermath of the credit crisis and the bursting of the housing bubble, we all have a great deal of cleanup work to do, as we try to help the American financial system recover from the worst combination of blows many of us can ever remember.

Credit unions remain one of the safest sectors of the financial services industry. Yet even credit unions were shaken by the economic earthquake – and no topic has challenged us as much as the corporate credit union crisis.

The corporate crisis has tested the patience and perseverance of us all.

At NCUA, we have been grappling day and night with the challenge of devising a plan that would, once and for all, resolve the situation.

On September 24th, we unveiled our comprehensive resolution plan. I am pleased to say The credit union community welcomed the plan and the rigorous approach we announced.

Over the past two years, we have been open and transparent as we were crafting the plan. NCUA kept in close touch with the credit union leaders and members – through "town hall" forums, briefings, webinars and face-to-face meetings. Over several months' worth of speeches across the country, members of the NCUA Board had foreshadowed our decision on the corporate situation. Most credit union leaders knew that dramatic steps had to be taken, and they were ready to hear a comprehensive resolution plan.

NCUA will do our best to make sure that the transition to the new corporate regulatory regime is smooth. We will make refinements as necessary. But, on balance, most fair-minded observers agree that our plan is sound for its comprehensive scope, its realistic cost estimates, and its likely chances of success.

In my remarks today, I would like to give you an overview of the details of the resolution plan, describing the changes that have been enacted and outlining the actions that must come next.

For those of you who were wondering why it took so long for NCUA to announce its comprehensive plan: Let me just say that there was a vast array of legal complexities and financial calculations involved in designing it. Working with the NCUA Board, it took the tireless work of dozens of NCUA's top staff – to craft a workable, practical, least-cost solution to the tangled corporate situation. NCUA also coordinated its plan carefully with the Department of the Treasury and the Federal Reserve.

As you consider the details of the corporate resolution plan, I urge you to keep in mind three factors:

First: For credit unions, NCUA's share guarantee remains in full effect. For consumers, their money continues to be protected by federal deposit insurance, up to $250,000 per account. The 90 million consumers who entrust their savings to a credit union can be confident that the system is stable and secure. Federally insured credit unions remain a safe and sound place to keep your money – and corporate credit unions are poised for renewal.

Second: This plan offers a comprehensive *solution* to a long-running problem – giving us a coordinated way to put an end to a situation that arose two years ago. This plan fulfills the three-stage process that NCUA has foreseen from the outset – the process of stabilization, resolution and reform. The credit union system has been successfully stabilized. There have been – and there will be – no disruptions in service to credit unions or consumers. This plan opens the way toward a future of stronger corporate credit unions, with the leaders of consumer credit unions empowered to decide the framework of the future system.

Third: This is not a government bailout. Not one dime of taxpayer money will be at risk. This problem had its origins in the private sector, and it will derive its solution from the private sector. In this resolution plan, it will be up to the vast majority of credit unions – which have been well-managed and financially stable – to pay into the system, to cover any losses. It is unfortunate that the credit unions that did nothing wrong must pay for the misjudgments of a relative few – yet that is the nature of a mutually insured system of cooperative credit.

This problem has been so complex, It took literally dozens of our top staff members more than a year to design this pragmatic, step-by-step process. The latest steps the NCUA Board has taken – including the additional conservatorships, the plan to dispose of the "legacy assets" in a cost-effective way, and the adoption of a strong new corporate rule, taken together, will resolve the corporate problem and open the way toward a promising future for credit unions.

Throughout the decision-making process, our actions have aimed to fulfill the four guiding principles that we set forth at the beginning of the corporate crisis: prevent any interruption in services to consumer credit unions; preserve public confidence in the credit union system; manage the situation to achieve the lowest long-term cost, and make an orderly transition to a new regulatory regime, based on the principle that consumer credit unions should determine the new contours of the realigned corporate system.

I am confident that the plan we have adopted will achieve all four of those principles.

We must remember how credit unions became caught up in this corporate situation. The sudden tightening of credit in late 2008 and 2009 delivered a severe shock to the entire financial system. Credit unions were caught in the crisis because the corporates had decided to amass a reckless level of concentration in securities that once bore a Triple-A rating, but that turned out to be highly dangerous. The most explosive factor was their over-concentration in private-label mortgage-backed securities – plus a handful of other dangerous assets, like swaps and derivatives.

When the market for these securities came to a screeching halt in late 2008, the credit union system quickly faced a potentially mortal threat. If NCUA had not moved decisively to stabilize the system, the resulting cascade of losses could have posed a catastrophe for the entire credit union system. The risk of a "fire sale" of assets would have inflicted grave losses on the 27 corporates, on consumer credit unions, and the Share Insurance Fund. in turn, The need to replenish the Fund, would have required heavy assessments on consumer credit unions – leading to the failure of as many as 1,200 – consumer credit unions. This would have required a recapitalization of the Share Insurance Fund – time after time and would have led to the failure of at least 1,000 additional consumer credit unions. The likely loss of public confidence in the credit union system, and the likelihood of “runs” by panicked consumers, would have effectively destroyed the value of the entire system.

Had cascading loses been allowed to destroy so much of the system the damage that might have occurred would have been catastrophic.

If there had been a “fire sale” of assets in December, 2008, the losses would have been an estimated 30 billion dollars.

And the “cascade effect” – counting the cost of additional credit union failures – would have been another 40 billion dollars.

Since the damage under that scenario would have been intolerable, NCUA had to take a more patient course. Our approach focused on a three-stage solution to the problem. First, we stabilized the system in the short term – preventing any “runs” on credit unions and keeping the system liquid. Second, we aimed to resolve the troubled corporates and deal with their impaired assets in the medium term. AND Third, we created a plan to reform the corporate system for the long term, through a tightened regulatory regime for the corporates that would prevent such a crisis from ever happening again.

Step by step, in late 2008 and throughout 2009, NCUA took methodical action to stabilize the system and to reassure depositors. We sought congressional authorization to gain additional flexibility for SUCH RESOURCES as our CENTRAL Liquidity Facility. We created several programs to reassure those who had shares in the corporates. We borrowed 1 billion dollars from the Treasury to allow us to put a billion-dollar capital note into U.S. Central, to provide it with added liquidity. And, in a crucial step, we created the Corporate Stabilization Fund, which will be pivotal in funding the resolution plan.

Taken together, these steps reassured the public that the credit union system was still a safe and sound place to keep their money. The pragmatic approach we took – step by step – moved from stabilization toward resolution, envisioning comprehensive reform for the long term.

Some have asked: since the initial stabilization efforts worked so well, why did NCUA have to go any further? Why not simply keep the status quo?

There are powerful reasons why the status quo was clearly unacceptable. Keeping the status quo would not have been in the best interest of the credit union industry. Uncertainty over the fate of the corporates has hindered credit union executives' ability to make plans for the long term. Prolonging the uncertainty would have left credit unions exposed to the risk of a liquidity event, just as they have been vulnerable to interest-rate risk. And, fundamentally, letting the status quo continue would not have been sound public policy. The "too big to fail" doctrine exposes the system to a "moral hazard" in which wrongdoers pay no price for their negligence.

Failed or failing institutions cannot be – and should not be – propped up forever. NCUA stepped in when we had to – in an emergency – to stabilize the system, to protect the members of natural person credit unions, and to maintain public confidence. But it is not the public sector's role to run a corporate credit union for the long term. That's the private sector's role. Now that the emergency has been dealt with and the situation has been stabilized, it is time for the private sector to take up its proper role once again.

The resolution strategy we decided upon was this: By isolating the legacy assets, we will not have to sell them at severely distressed prices. By securitizing them and giving them a U.S. government guarantee, we will be able to sell them to investors on the open market. By using the funds raised by these sales, we will fund the resolution process. . . helping ensure that we resolve the situation at the lowest possible cost, consistent with wise public policy.

We will now be able to move into a transition phase where – for a limited time – so-called “bridge corporates” will ensure that services continue to consumer credit unions, providing time for credit union boards and executives to decide on where they would prefer to obtain the services they need for the future – once the “bridge corporates” have been wound-down.

The five corporates that have now been taken into conservatorship have no realistic chance of ever returning to adequate capitalization. They were undone, fundamentally, by their excessive concentrations in mortgage-backed securities:

These five corporates made extremely bad decisions by over-concentrating in mortgage-backed securities – in the case of WesCorp, putting 70 percent of its investments in one sector, which was a flagrant misjudgment. However, together, these five corporates account for most of the mortgage-backed securities that are held by the corporates, overall. So, by resolving these five, we will have effectively taken care of most of the system’s MBS problem.

To resolve the five corporates, we’re using a technique that has become widely used, in the United States and in other nations that have suffered through the financial crisis:

We will split the old institution into a “good bank” and a “bad bank” – with the assets that are still valuable going up into the “bridge corporate” – the “good bank” . . . . and with the impaired assets going down into an “asset management estate” – the “bad bank,” where tough decisions will have to be made about possible, eventual liquidation.

The use of the “good bank bad bank” model will lead to the isolation of the legacy assets, preparing the way for them to be moved into a “securitization trust” from which they can be sold. The bridge corporate can focus on providing continuing services to credit unions, while the asset management estate is a device that allows for the preservation of any legal claims.

This “good bank bad bank” model thus provides a measure of stability and predictability. With the share guarantee remaining in place through the end of 2012, credit unions can be assured of continued services from the corporates . . . while costs will be contained. The “isolate and fund” strategy can thus move forward: The isolated legacy assets can be prepared for securitization and sale – with the proceeds from those sales going toward the funding of the resolution process.

Let me underscore an important fact: Maintaining the deposits of consumer credit unions, in the bridge corporates, is vital for the stability of the system as we await the proceeds of the sale of the legacy assets. To maintain adequate cash-flow, it is important that consumer credit unions be encouraged to keep their deposits right where they are: in their corporates. Since the Share Guarantee remains in effect, there is certainly no reason for consumer credit unions to withdraw their money hastily. Their money was safe yesterday, and it will be safe tomorrow.

And now comes the question everyone asks: How much will all this cost?

At this point, we can only state the numbers as a range, as we wait to see what the proceeds will be from the securitization and sale of the legacy assets. As of mid-year: There has already been $5.6 billion in member capital that has been depleted. Since the projected total cost of the losses is an overall total of $13.9 billion to $16.1 billion . . . subtracting the $5.6 billion that is already gone . . . the “bottom line” is that the credit union system, as a whole, is facing a total projected cost of $8.3 billion to $10.5 billion. That is the amount that must be paid into the Stabilization Fund through June 2021, when the life of the fund will come to an end.

Of that amount -- $8.3 TO $10.5Billion… credit unions have already paid $1.3 billion into the stabilization fund, through assessments made in 2009 and 2010. So, even after what they have paid so far, credit unions are facing another $7 billion to $9.2 billion. That amount will be stretched-out over the next 10 years.

Some have asked whether there may be any chance for some adjustments in the amount of assessments – perhaps taking into account a consumer credit union's size. Unfortunately, the law gives us no flexibility on that matter. Even if we wanted to ease the burden on some credit unions, the statute requires that all assessments be made equally. So we can expect that just the cost of the coming assessments will put some significant pressure on credit unions' finances.

Once the credit union system has worked its way through this expensive problem, I believe that its future will be bright. We have succeeded in creating a resolution plan that, to the extent possible, minimizes the costs and maximizes the flexibility of decision-making by credit union leaders.

But there will be difficult decisions along the way some of them requiring action quite soon.

The "bridge corporates" will only be in existence for a targeted two years – so consumer credit unions must not delay making their decisions about where they will seek services in the future.

The corporates that remain, after the resolution of the troubled five that have now been conserved, will need to articulate their value proposition to their potential new members, even as they prepare to come into compliance with the standards set in the new corporate rule.

But, after the hard work of this resolution process, we will at least be able to say that this type of crisis will never strike again. The factor that will prevent such a crisis is the newly strengthened corporate rule.

In crafting a new corporate rule, NCUA set out to fundamentally reform the way the corporates operate. And to make sure that never again will such a corporate crisis be possible.

The process of crafting the new rule has drawn on the best thinking of the credit union community. We invited the input of every stakeholder, and the outpouring of responses has helped us reach a better understanding of how to reform the corporate network.

NCUA's Board started the process in January of 2009 by issuing an Advance Notice of Proposed Rulemaking – which drew 445 responses, with about 1,500 pages of comments. Then in November of 2009, when the Board outlined our proposed rule, we received more than 800 responses – with another 2,500 pages of comments. And, yes, each and every page was read.

As we considered the vast range of comments, we adjusted our proposed rule to incorporate your very best ideas. The result is a final rule that emphasizes realism, rigor and responsibility. The new rule defines the overall boundaries for the corporates, which will continue to provide the familiar services that member credit unions have come to rely on.

The new corporate rule has four main themes.

On capital standards: The new rule will significantly strengthen capital requirements – aligning corporates with Basel One standards; subjecting corporates to a leverage capital requirement in an effort to reduce risk; and imposing Prompt Corrective Action standards on corporates that match those that apply to all other federally insured financial institutions.

On asset-liability management: It includes specific requirements to limit the average life of assets, ensuring that they will not present excessive liquidity risks. It also prohibits a corporate from accepting funds from a single source that exceeds 15 percent of the corporate's assets. This will avoid excessive reliance on a single lender or depositor.

On risk concentration: It will limit credit risks by forbidding corporates from purchasing any private-label mortgage-backed securities or subordinated securities. It will also prohibit excessive concentration in any other single type of asset. Promoting a diverse portfolio of investments will help avoid the kind of risk concentration that was permitted under the flawed corporate rule that was approved in 2002.

And finally: On governance standards: It will raise standards for corporate board member qualifications, aiming to elevate each director's level of experience and expertise.

Improvements in these areas will go a long way toward preventing a recurrence of the kind of corporate crisis we have just endured.

The new corporate rule also makes it clear that consumer credit unions are empowered to make decisions about the future of the corporates. Taken together, the business judgments made by the nation's 7,500 consumer credit unions will shape the new corporate structure. It will be up to the board members and executives of THOSE credit unions to determine whether to continue to use a corporate credit union or whether to seek alternative methods to fulfill their operational and liquidity needs. As consumer credit unions gradually make their individual decisions, they will collectively shape the future of the corporates.

To help executives and board members make sound decisions, NCUA produced a DVD with detailed presentations on the corporates' history, structure, and recent financial problems. We also posted the video presentations on our website, and we sent one to every credit union. We hope that the DVD is helping credit union leaders fully understand the corporate system – and is preparing you for the choices you will soon need to make, as the corporate system is realigned.

I have given you an overview of the process that will resolve the corporate crisis -- and of the ideas in the new corporate rule that will prevent any recurrence of such a crisis. This summary is slightly simplified, but it presents the overall outlines of the work that has been done, and the work that remains to be done.

It will take some time – perhaps the full two years that we foresee as the lifespan of the "bridge corporates" – to make all the decisions and transitional moves that will be needed to create the stronger, realigned system that we now envision. But now that a comprehensive plan has been set in motion, we can look ahead toward a future with stronger corporates – and with added flexibility for consumer credit unions.

The painstaking process of creating this comprehensive plan has taken more than a year, and implementing it will require at least that much time. But, once the process is completed, we will be able to reassure the public that we fulfilled our mission at the lowest cost to credit unions . . . at no cost to the taxpayer . . . and with no disruption of services to consumers or credit unions.

With a new corporate rule . . . with a new legacy assets plan . . . with stronger public confidence in the safeguards that keep the system strong . . . America's credit unions will emerge from the corporate crisis stronger than ever.

We have now turned the page – from a challenging chapter in credit union history, to a new chapter that offers an even more promising future.

Protecting the credit union system, and the 90 million members it serves, remains our highest priority.

I feel confident that the new resolution plan will strengthen the system's safeguards – validating depositors' confidence in a well-regulated system that puts the interests of consumers first.

I believe that a revitalized industry will be well-positioned to fulfill the mission of credit unions: bringing high-quality, low-cost financial services to another generation of Americans, who are eager to save and invest for a brighter future.

Together, we can take today's resilient system and make it even stronger – ensuring that the system will deliver on its promises long into the future.

Thank you for listening.